

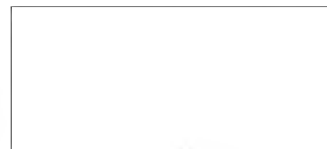
UNITED STATES CIVIL SERVICE COMMISSION  
BUREAU OF RETIREMENT AND INSURANCE  
WASHINGTON 25, D.C.

STAT

STAT

JUN 28 1963


President  
Government Employees Health Assn., Inc.  
P. O. Box 463  
Washington 4, D. C.



*Do you need  
this or to file?*



*8/1/63*

Dear Mr. 

Attached for your advance information are two copies of a revision of the Accounting and Reporting provisions to be included as part of your Health Benefits contract with the Civil Service Commission effective November 1, 1963.

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The following substantive changes or clarifications have been made to the provisions of the current Appendix B:

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(1) Special Reserve

(a) That portion of § 89.11 (9) of the Regulations which requires a pay back to the Contingency Reserve when a plan's special reserve exceeds the latest three calendar months' subscription charges has been deleted effective November 1, 1963. Accordingly, former paragraph 2 of "B. Special Reserve" of your current Appendix B has been deleted from this revision.

(b) Former paragraph 3 has been rewritten for clarity without any change in concept.

(2) Payment from Contingency Reserve


This is a new paragraph which recognizes the obligation of the Commission to automatically pay additional subscription charges once a year (February or March) if the conditions of § 89.23 of the Regulations as revised effective November 1, 1963 are met.

(3) Expenses and Retention Charges

- (a) The Schedule has been clarified to make it clear that only Administrative Charges incurred for goods received and services rendered during the contract term can be charged against the subscription charges of that year. There can be no carry-over of costs against the following or subsequent periods' limitation of the costs of a previous period in excess of that period's percentage limitation.
- (b) A guide for recognizing the allowability of a cost against a cost reimbursement type Government contract is contained in Title 32, Code of Federal Regulations. Carriers and the Commission have found a need for a common understanding of which costs are acceptable or unacceptable as Administrative Charges against our experience rated contracts. Some of the carriers in the Health Benefits Program are also contractors with the Department of the Army under Medicare whereby these Regulations are part of the contract (by references). A copy of the applicable Federal Regulations is enclosed.

Any questions or comments to the attached Appendix B should be referred to Mr. Harold E. Hunsaker prior to July 15, 1963.

Sincerely yours,

  
Assistant to the Chief  
Contract & Instructions Division

Enclosure

## APPENDIX B

## ACCOUNTING AND REPORTING

A. Annual Accounting.

The Carrier agrees to maintain financial records under generally accepted accounting principles and, not later than ninety days after the end of each contract term, to furnish to the Commission for that contract term an accounting of its operations under the contract. The accounting shall be in the form prescribed by the Commission and shall include, among other things, the following items with respect to each option, if there be two options, provided by the contract:

- (1) The amount of subscription charges received, accrued, and paid from the Contingency Reserve;
- (2) The amount of health benefits charges paid and the amount of reserves for accrued health benefits charges;
- (3) The amount of expenses and retention charges incurred, not to exceed the amounts specified in Section E;
- (4) The amount of income on investments;
- (5) The algebraic sum of items (1) minus (2) minus (3) plus (4).

B. Special Reserve.

1. This contract is experience rated. The cumulative gain on operations under this contract, as of any date and without regard to options and as determined by the algebraic sum of the amounts applicable to item (5) in Section A from the effective date of this contract minus the amounts of any subscription charges returned to the Commission under previous contract provisions, shall constitute the Special Reserve held by the Carrier to be used for charges under this contract only.

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2. If this contract is discontinued and there is a positive balance remaining in the Special Reserve after all health benefit charges plus the agreed-upon amount of administrative expenses for contract liquidation have been paid, such balance, including current income on the investment of such balance, shall be paid to the Commission for credit to the Fund within two years from the date this contract is discontinued.

C. Payment from Contingency Reserve.

Whenever, as of the end of any contract term, the total of the Special Reserve and reserves for accrued health benefits charges held by the Carrier for the plan amount to less than the total of the last five months' subscription charges paid from the fund, the Carrier is entitled in the subsequent contract term to a payment of additional subscription charges in accordance with § 89.23 of the Commission's Regulations.

D. Health Benefits Charges.

In determining the amount of health benefits charges incurred for item (2) in Section A, there shall be included: (1) the paid charges, and (2) the accrued charges attributable to enrollees and dependents under this contract, equitably and reasonably determined on the basis of experience under this contract. On the basis of audit, such charges shall be subject to adjustments as agreed upon by the Carrier and the Commission.

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E. Expenses and Retention Charges.Schedule

<u>Item</u>	<u>Amount</u>
(a) Expense Charges	
(i) Administrative Charges, Organization	The actual amount incurred during the contract term but not in excess of ____% of total subscription charges.
(ii) Administrative Charges, Underwriter	The actual amount incurred during the contract term but not in excess of ____% of total subscription charges.
(iii) Taxes	The actual amount incurred during the contract term.
(iv) Commission	____% of total subscription charges for the contract term.
(b) Risk Charges	____% of total subscription charges for the contract term.

"Administrative Charges" mean the amount of expenses incurred in connection with the administration of this contract (exclusive of expenses attributable to providing health services in item (2) in Section A), including, but not limited to, the cost of maintaining the eligibility files for coverage under this contract, the cost of investigation and settlement of claims under this contract, and the cost of making accounting and statistical analysis under this contract. "Administrative Charges" allocated to this contract shall be the actual, necessary incurred expenses determined on an equitable and reasonable basis, with proper justification and accounting support. Sub-Part B

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of Part 15 of Chapter 1 of Title 32, Code of Federal Regulations, shall be used as the guide in the determination of acceptable Administrative Charges. On the basis of audit, the Commission may direct that adjustments not inconsistent with the above regulations be made and that they be recorded in subsequent contract term Accounting Statements.

"Taxes," if applicable, mean all Governmental fees and taxes which are directly attributable to this contract.

F. Income on Investments.

The Special Reserve and current subscription charges received from the Fund which are in excess of current cash requirements shall be prudently invested. Current cash requirements are funds necessary for prompt payment of charges under this contract as determined by the Carrier.

G. Interim Accounting.

The Carrier agrees to furnish upon request of the Commission, such other reasonable financial reports with respect to operations under this contract as are necessary to enable the Commission to carry out its functions under the Act.

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Excerpt from

TITLE 32 - CODE OF FEDERAL REGULATIONS

Subpart B of Part 15 of Chapter 1  
(Revised as of January 1, 1961)

Principles and Procedures for  
Use in Cost-Reimbursement Type  
Supply and Research Contracts  
With Commercial Organizations

U. S. Civil Service Commission  
Bureau of Retirement and Insurance  
Washington 25, D. C.

June 24, 1963

**Subpart B—Principles and Procedures for Use in Cost-Reimbursement Type Supply and Research Contracts With Commercial Organizations**

**§ 15.201 Basic considerations.**

**§ 15.201-1 Composition of total cost.**

The total cost of a contract is the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits. In ascertaining what constitutes costs, any generally accepted method of determining or estimating costs that is equitable under the circumstances may be used, including standard costs properly adjusted for applicable variances.

**§ 15.201-2 Factors affecting allowability of costs.**

Factors to be considered in determining the allowability of individual items of cost include (a) reasonableness, (b) allocability, (c) application of those generally accepted accounting principles and practices appropriate to the particular circumstances, and (d) any limitations or exclusions set forth in this subpart, or otherwise included in the contract as to types or amounts of cost items.

**§ 15.201-3 Definition of reasonableness.**

A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by an ordinarily prudent person in the conduct of competitive business. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with firms or separate divisions thereof which may not be subject to effective competitive restraints. What is reasonable depends upon a variety of considerations and circumstances involving both the nature and amount of the cost in question. In determining the reasonableness of a given cost, consideration shall be given to:

(a) Whether the cost is of a type generally recognized as ordinary and necessary for the conduct of the contractor's business or the performance of the contract;

(b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arm's length bargaining, Federal and State

laws and regulations, and contract terms and specifications;

(c) The action that a prudent business man would take in the circumstances, considering his responsibilities to the owners of the business, his employees, his customers, the Government and the public at large; and

(d) Significant deviations from the established practices of the contractor which may unjustifiably increase the contract costs.

**§ 15.201-4 Definition of allocability.**

A cost is allocable if it is assignable or chargeable to a particular cost objective, such as a contract, product, product line, process, or class of customer or activity, in accordance with the relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, or both Government work and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

**§ 15.201-5 Credits.**

The applicable portion of any income, rebate, allowance, and other credit relating to any allowable cost, received by or accruing to the contractor, shall be credited to the Government either as a cost reduction or by cash refund, as appropriate.

**§ 15.202 Direct costs.**

(a) A direct cost is any cost which can be identified specifically with a particular cost objective. Direct costs are not limited to items which are incorporated in the end product as material or labor. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly thereto. Costs identified specifically with other work of the contractor are direct costs of that work and are not to be charged to the contract directly or indirectly. When items ordinarily chargeable as indirect costs are charged to Government work as direct costs, the cost of like items applicable to other work of the contractor



must be eliminated from indirect costs allocated to Government work.

(b) This definition shall be applied to all items of cost of significant amount unless the contractor demonstrates that the application of any different current practice achieves substantially the same results. Direct cost items of minor amount may be distributed as indirect costs as provided in § 15.203.

#### § 15.203 Indirect costs.

(a) An indirect cost is one which, because of its incurrence for common or joint objectives, is not readily subject to treatment as a direct cost. Minor direct cost items may be considered to be indirect costs for reasons of practicality. After direct costs have been determined and charged directly to the contract or other work as appropriate, indirect costs are those remaining to be allocated to the several classes of work.

(b) Indirect costs shall be accumulated by logical cost groupings with due consideration of the reasons for incurring the costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives. Commonly, manufacturing overhead, selling expenses, and general and administrative expenses are separately grouped. Similarly, the particular case may require subdivisions of these groupings, e.g., building occupancy costs might be separable from those of personnel administration within the manufacturing overhead group. The number and composition of the groupings should be governed by practical considerations and should be such as not to complicate unduly the allocation where substantially the same results are achieved through less precise methods.

(c) Each cost grouping shall be distributed to the appropriate cost objectives. This necessitates the selection of a distribution base common to all cost objectives to which the grouping is to be allocated. The base should be selected so as to permit allocation of the grouping on the basis of the benefits accruing to the several cost objectives. This principle for selection is not to be applied so rigidly as to complicate unduly the allocation where substantially the same results are achieved through less precise methods.

(d) The method of allocation of indirect costs must be based on the par-

ticular circumstances involved. The method shall be in accord with those generally accepted accounting principles which are applicable in the circumstances. The contractor's established practices, if in accord with such accounting principles, shall generally be acceptable. However, the methods used by the contractor may require re-examination when:

(1) Any substantial difference occurs between the cost patterns of work under the contract and other work of the contractor; or

(2) Any significant change occurs in the nature of the business, the extent of subcontracting, fixed asset improvement programs, the inventories, the volume of sales and production, manufacturing processes, the contractor's products, or other relevant circumstances.

(e) A base period for allocation of indirect costs is the period during which such costs are incurred and accumulated for distribution to work performed in that period. Normally, the base period will be the contractor's fiscal year; however, use of a shorter period may be appropriate in case of (1) contracts whose performance involves only a minor portion of the fiscal year, or (2) where it is general practice in the industry to use a shorter period. In any event the base period or periods shall be so selected as to avoid inequities in the allocation of costs. When the contract is performed over an extended period of time, as many such base periods will be used as will be required to represent the period of contract performance.

#### § 15.204 Application of principles and procedures.

(a) Costs shall be allowed to the extent that they are reasonable (see § 15.201-3), allocable (see § 15.201-4), and determined to be allowable in view of the other factors set forth in §§ 15.201-2 and 15.205. These criteria apply to all of the selected items of cost which follow, notwithstanding that particular guidance is provided in connection with certain specific items for emphasis or clarity.

(b) Costs incurred as reimbursements to a subcontractor under a cost-reimbursement type subcontract of any tier above the first fixed-price subcontract are allowable to the extent that allowance is consistent with the subpart of this part which is appropriate to the

subcontract involved. Thus, if the subcontract is for supplies, such costs are allowable to the extent that the subcontractor's costs would be allowable if this subpart were incorporated in the subcontract; if the subcontract is for construction, such costs are allowable to the extent that the subcontractor's costs would be allowable if Subpart D of this part were incorporated in the subcontract.

(c) Selected items of cost are treated in § 15.205. However, § 15.205 does not cover every element of cost and every situation that might arise in a particular case. Failure to treat any item of cost in § 15.205 is not intended to imply that it is either allowable or unallowable. With respect to all items, whether or not specifically covered, determination of allowability shall be based on the principles and standards set forth in this subpart and, where appropriate, the treatment of similar or related selected items.

#### § 15.205 Selected costs.

##### § 15.205-1 Advertising costs.

(a) Advertising costs mean the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, trade papers, outdoor advertising, dealer cards and window displays, conventions, exhibits, free goods and samples, and the like. The following advertising costs are allowable:

(1) Advertising in trade and technical journals: *Provided*, Such advertising does not offer specific products or services for sale but is placed in journals which are valuable for dissemination of technical information within the contractor's industry;

(2) Help-wanted advertising, as set forth in § 15.205-33, when considered in conjunction with all other recruitment costs;

(3) Costs of participation in exhibits—

(i) Upon invitation of the Government, or

(ii) Which exhibits are for the purpose of disseminating technical information within the contractor's industry; however, such costs are not allowable under this subdivision if the exhibit offers specific products or services for sale;

(4) Advertising for the exclusive purpose of obtaining scarce materials, plant, or equipment, or disposing of scrap or surplus materials, in connection with the contract.

(b) Except as provided above, all other advertising costs are unallowable.

##### § 15.205-2 Bad debts.

Bad debts, including losses (whether actual or estimated) arising from uncollectible customers' accounts and other claims, related collection costs, and related legal costs, are unallowable.

##### § 15.205-3 Bidding costs.

Bidding costs are the costs of preparing bids or proposals on potential Government and non-Government contracts or projects, including the development of engineering data and cost data necessary to support the contractor's bids or proposals. Bidding costs of the current accounting period of both successful and unsuccessful bids and proposals normally will be treated as allowable indirect costs, in which event no bidding costs of past accounting periods shall be allowable in the current period to the Government contract. However, if the contractor's established practice is to treat bidding costs by some other method, the results obtained may be accepted only if found to be reasonable and equitable.

##### § 15.205-4 Bonding costs.

(a) Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the contractor. They arise also in instances where the contractor requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

(b) Costs of bonding required pursuant to the terms of the contract are allowable.

(c) Costs of bonding required by the contractor in the general conduct of his business are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

##### § 15.205-5 Civil defense costs.

(a) Civil defense costs are those incurred in planning for, and the protection of life and property against, the possible effects of enemy attack. Reasonable

costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire fighting training and equipment, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the contractor's premises pursuant to suggestions or requirements of civil defense authorities are allowable when allocated to all work of the contractor.

(b) Costs of capital assets under paragraph (a) of this section are allowable through depreciation in accordance with § 15.205-9.

(c) Contributions to local civil defense funds and projects are unallowable.

**§ 15.205-6 Compensation for personal services.**

(a) *General.* (1) Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor during the period of contract performance. It includes, but is not limited to, salaries, wages, directors' and executive committee members' fees, bonuses (including stock bonuses), incentive awards, employee stock options, employee insurance, fringe benefits, and contributions to pension, annuity, and management employee incentive compensation plans. Except as otherwise specifically provided in this § 15.205-6, such costs are allowable to the extent that the total compensation of individual employees is reasonable for the services rendered and they are not in excess of those costs which are allowable by the Internal Revenue Code and regulations thereunder.

(2) Compensation is reasonable to the extent that the total amount paid or accrued is commensurate with compensation paid under the contractor's established policy and conforms generally to compensation paid by other firms of the same size, in the same industry, or in the same geographic area, for similar services. In the administration of this principle, it is recognized that not every compensation case need be subjected in detail to the above tests. Such tests need be applied only to those cases in which a general review reveals amounts or types of compensation which appear unreasonable or otherwise out of line. However, certain conditions give rise to the need for special consideration and

possible limitation as to allowability for contract cost purposes where amounts appear excessive. Among such conditions are the following:

(i) Compensation to owners of closely held corporations, partners, sole proprietors, or members of the immediate families thereof, or to persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of profits.

(ii) Any change in a contractor's compensation policy resulting in a substantial increase in the contractor's level of compensation, particularly when it was concurrent with an increase in the ratio of Government contracts to other business, or any change in the treatment of allowability of specific types of compensation due to changes in Government policy.

(iii) The contractor's business is such that his compensation levels are not subject to the restraints normally occurring in the conduct of competitive business.

(3) Compensation in lieu of salary for services rendered by partners and sole proprietors will be allowed to the extent that it is reasonable and does not constitute a distribution of profits.

(4) In addition to the general requirements set forth in subparagraphs (1) through (3) of this paragraph, certain forms of compensation are subject to further requirements as specified in paragraphs (b) through (i) of this section.

(b) *Salaries and wages.* Salaries and wages for current services include gross compensation paid to employees in the form of cash, products, or services, and are allowable. However, premiums for overtime, extra-pay shifts, and multi-shift work are allowable to the extent approved pursuant to § 12.102-4 of this chapter or permitted pursuant to § 12.102-5 of this chapter.

(c) *Cash bonuses and incentive compensation.* Incentive compensation for management employees, cash bonuses, suggestion awards, safety awards, and incentive compensation based on production, cost reduction, or efficient performance, are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid

or accrued pursuant to an agreement entered into in good faith between the contractor and the employees before the services were rendered, or pursuant to an established plan followed by the contractor so consistently as to imply, in effect, an agreement to make such payment. (But see § 15.107.) Bonuses, awards, and incentive compensation when any of them are deferred are allowable to the extent provided in (f) below.

(d) *Bonuses and incentive compensation paid in stock.* Costs of bonuses and incentive compensation paid in the stock of the contractor or of an affiliate are allowable to the extent set forth in paragraph (c) of this section (including the incorporation of the principles of paragraph (f) of this section for deferred bonuses and incentive compensation), subject to the following additional requirements:

(1) Valuation placed on the stock transferred shall be the fair market value at the time of transfer, determined upon the most objective basis available; and

(2) Accruals for the cost of stock prior to the issuance of such stock to the employees shall be subject to adjustment according to the possibilities that the employees will not receive such stock and their interest in the accruals will be forfeited.

Such costs otherwise allowable are subject to adjustment according to the principles set forth in paragraph (f) (3) of this section. (But see § 15.107.)

(e) *Stock options.* The cost of options to employees to purchase stock of the contractor or of an affiliate is unallowable.

(f) *Deferred compensation.* (1) As used herein, deferred compensation includes all remuneration, in whatever form, for which the employee is not paid until after the lapse of a stated period of years or the occurrence of other events as provided in the plans, except that it does not include normal end of accounting period accruals. It includes (i) contributions to pension, annuity, stock bonus, and profit sharing plans, (ii) contributions to disability, withdrawal, insurance, survivorship, and similar benefit plans, and (iii) other deferred compensation, whether paid in cash or in stock.

(2) Deferred compensation is allowable to the extent that (i) except for past service pension and retirement costs, it is for services rendered during the contract period; (ii) it is, together with all other compensation paid to the employee, reasonable in amount; (iii) it is paid pursuant to an agreement entered into in good faith between the contractor and employees before the services are rendered, or pursuant to an established plan followed by the contractor so consistently as to imply, in effect, an agreement to make such payments; and (iv) for a plan which is subject to approval by the Internal Revenue Service, it falls within the criteria and standards of the Internal Revenue Code and the regulations of the Internal Revenue Service. (But see § 15.107.)

(3) In determining the cost of deferred compensation allowable under the contract, appropriate adjustments shall be made for credits or gains, including those arising out of both normal and abnormal employee turnover, or any other contingencies that can result in a forfeiture by employees of such deferred compensation. Adjustments shall be made only for forfeitures which directly or indirectly inure to the benefit of the contractor; forfeitures which inure to the benefit of other employees covered by a deferred compensation plan with no reduction in the contractor's costs will not normally give rise to adjustment in contract costs. Adjustments for normal employee turnover shall be based on the contractor's experience and on foreseeable prospects, and shall be reflected in the amount of cost currently allowable. Such adjustments will be unnecessary to the extent that the contractor can demonstrate that its contributions take into account normal forfeitures. Adjustments for possible future abnormal forfeitures shall be effected according to the following rules:

(i) Abnormal forfeitures that are foreseeable and which can be currently evaluated with reasonable accuracy, by actuarial or other sound computation, shall be reflected by an adjustment of current costs otherwise allowable; and

(ii) Abnormal forfeitures, not within (i) above, may be made the subject of agreement between the Government and the contractor either as to an equitable adjustment or a method of determining such adjustment.

(4) In determining whether deferred compensation is for services rendered during the contract period or is for future services, consideration shall be given to conditions imposed upon eventual payment, such as, requirements of continued employment, consultation after retirement, and covenants not to compete.

(g) *Fringe benefits.* Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. Costs of fringe benefits, such as pay for vacations, holidays, sick leave, military leave, employee insurance, and supplemental employment benefit plans are allowable to the extent required by law, employer-employee agreement, or an established policy of the contractor.

(h) *Severance pay.* See § 15.205-39.

(i) *Training and education expenses.* See § 15.205-44.

#### § 15.205-7 Contingencies.

(a) A contingency is a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at a present time.

(b) In historical costing, contingencies are not normally present since such costing deals with costs which have been incurred and recorded on the contractor's books. Accordingly, contingencies are generally unallowable for historical costing purposes. However, in some cases, as for example, terminations, a contingency factor may be recognized which is applicable to a past period to give recognition to minor unsettled factors in the interest of expeditious settlement.

(c) In connection with estimates of future costs, contingencies fall into two categories:

(1) Those which may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; *e.g.*, anticipated costs of rejects and defective work; in such situations where they exist, contingencies of this category are to be included in the estimates of future cost so as to provide the best estimate of performance costs; and

(2) Those which may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government; *e.g.*, results of pending litigation, and

other general business risks. Contingencies of this category are to be excluded from cost estimates under the several items of cost, but should be disclosed separately, including the basis upon which the contingency is computed in order to facilitate the negotiation of appropriate contractual coverage (see, for example, §§ 15.205-16, 15.205-20, and 15.205-39).

#### § 15.205-8 Contributions and donations.

Contributions and donations are unallowable.

#### § 15.205-9 Depreciation.

(a) Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life has reference to the prospective period of economic usefulness in the particular contractor's operations as distinguished from physical life.

(b) Normal depreciation on a contractor's plant, equipment, and other capital facilities is an allowable element of contract cost: *Provided*, That the amount thereof is computed:

(1) Upon the property cost basis used by the contractor for Federal income tax purposes (see section 167 of the Internal Revenue Code of 1954); or

(2) In the case of nonprofit or tax-exempt organizations, upon a property cost basis which could have been used by the contractor for Federal income tax purposes, had such organizations been subject to the payment of income tax; and in either case

(3) By the consistent application to the assets concerned of any generally accepted accounting method, and subject to the limitations of the Internal Revenue Code of 1954, as amended, including—

(i) The straight line method;

(ii) The declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in subdivision (i) of this paragraph;

(iii) The sum of the years-digits method; and

(iv) Any other consistent method productive of an annual allowance which,

when added to all allowances for the period commencing with the use of the property and including the current year, does not, during the first two-thirds of the useful life of the property, exceed the total of such allowances which would have been used had such allowances been computed under the method described in subdivision (ii) of this subparagraph.

(c) Depreciation should usually be allocated to the contract and other work as an indirect cost. The amount of depreciation allowed in any accounting period may, consistent with the basic objectives set forth in paragraph (a) of this section, vary with volume of production or use of multi-shift operations.

(d) In the case of emergency facilities covered by certificates of necessity a contractor may elect to use normal depreciation without requesting a determination of "true depreciation" or may elect to use either normal or "true depreciation" after a determination of "true depreciation" has been made by an Emergency Facilities Depreciation Board. The method elected must be followed consistently throughout the life of the emergency facility. Where an election is made to use normal depreciation, the amount thereof for both the emergency period and the post-emergency period shall be computed in accordance with paragraph (b) of this section. Where an election is made to use "true depreciation," the amount allowable as depreciation:

(1) With respect to the emergency period (5 years), shall be computed in accordance with the determination of the Emergency Facilities Depreciation Board and allocated ratably over the full five year emergency period; provided no other allowance is made which would duplicate the factors, such as extraordinary obsolescence, covered by the Board's determination; and

(2) After the end of the emergency period, shall be computed by distributing the remaining undepreciated portion of the cost of the emergency facility over the balance of its useful life (but see paragraph (e) of this section); provided the remaining undepreciated portion of such cost shall not include any amount of unrecovered "true depreciation."

(e) Depreciation on idle or excess facilities shall not be allowed except on such facilities as are reasonably necessary for standby purposes.

(f) No depreciation, rental, or use charge shall be allowed on the contractor's assets which have been fully depreciated when a substantial portion of such depreciation was on a basis that represented, in effect, a recovery thereof as a charge against Government contracts or subcontracts. Otherwise, a reasonable use charge may be agreed upon and allowed. (But see § 15.107.) In determining this charge, consideration should be given to cost, total estimated useful life at time of negotiation, and effect of any increased maintenance charges or decreased efficiency due to age.

#### § 15.205-10 Employee morale, health, and welfare costs and credits.

Reasonable costs of health and welfare activities, such as house publications, health or first-aid clinics, recreational activities, and employee counseling services, incurred, in accordance with the contractor's established practice or custom in the industry or area, for the improvement of working conditions, employer-employee relations, employee morale, and employee performance, are allowable. Income generated from any of these activities shall be credited to the costs thereof unless such income has been irrevocably set over to employee welfare organizations.

#### § 15.205-11 Entertainment costs.

Costs of amusement, diversion, social activities and incidental costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities, are unallowable (but see §§ 15.205-10 and 15.205-43).

#### § 15.205-12 Excess facility costs.

Costs of maintaining, repairing, and housing idle and excess contractor-owned facilities, except those reasonably necessary for standby purposes, are unallowable. Any costs of excess plant capacity reserved for defense mobilization production which are to be paid for by the Government should be the subject of a separate contract.

#### § 15.205-13 Fines and penalties.

Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the contract, or instructions in writing from the contracting officer.

**§ 15.205-14 Food service and dormitory costs and credits.**

Food and dormitory services include operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations or similar types of services for the contractor's employees at or near the contractor's facilities. Reasonable losses from the operation of such services are allowable if they are allocated to all activities served. Profits (except profits irrevocably set over to an employee welfare organization of the contractor in amounts reasonably useful for the benefit of the employees at the site or sites of contract performance) accruing to the contractor from the operation of these services, whether operated by the contractor or by a concessionaire, shall be treated as a credit, and allocated to all activities served.

**§ 15.205-15 Fringe benefits.**

(See § 15.205-6(g).)

**§ 15.205-16 Insurance and indemnification.**

(a) Insurance includes insurance which the contractor is required to carry, or which is approved, under the terms of the contract, and any other insurance which the contractor maintains in connection with the general conduct of his business.

(1) Costs of insurance required or approved, and maintained, pursuant to the contract, are allowable.

(2) Costs of other insurance maintained by the contractor in connection with the general conduct of his business are allowable subject to the following limitations:

(i) Types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances;

(ii) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of profit;

(iii) Costs of insurance or of any provision for a reserve covering the risk of loss of or damage to Government property are allowable only to the extent that the contractor is liable for such loss or damage and such insurance or reserve does not cover loss or damage which results from willful misconduct or lack of good faith on the part of any of the con-

tractor's directors or officers, or other equivalent representatives, who has supervision or direction of (a) all or substantially all of the contractor's business, or (b) all or substantially all of the contractor's operations at any one plant or separate location in which the contract is being performed, or (c) a separate and complete industrial operation in connection with the performance of the contract;

(iv) Provisions for a reserve under an approved self-insurance program are allowable to the extent that the types of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks; and

(v) Costs of insurance on the lives of officers, partners, or proprietors are allowable only to the extent that the insurance represents additional compensation (see § 15.205-6).

(3) Actual losses which could have been covered by permissible insurance (through an approved self-insurance program or otherwise) are unallowable unless expressly provided for in the contract, except:

(i) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice, are allowable; and

(ii) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of small hand tools, which occur in the ordinary course of doing business, are allowable.

(b) Indemnification includes securing the contractor against liabilities to third persons and any other loss or damage, not compensated by insurance or otherwise. The Government is obligated to indemnify the contractor only to the extent expressly provided for in the contract, except as provided in paragraph (a) (3) of this section.

**§ 15.205-17 Interest and other financial costs.**

Interest on borrowings (however represented), bond discounts, costs of financing and refinancing operations, legal and professional fees paid in connection with the preparation of prospectuses, costs of preparation and issuance of stock rights, and costs related thereto,



are unallowable except for interest assessed by State or local taxing authorities under the conditions set forth in § 15.205-41. (But see § 15.205-24.)

#### § 15.205-18 Labor relations costs.

Costs incurred in maintaining satisfactory relations between the contractor and its employees, including costs of shop stewards, labor management committees, employee publications, and other related activities, are allowable.

#### § 15.205-19 Losses on other contracts.

An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts), whether such other contract is of a supply, research and development, or other nature, is unallowable.

#### § 15.205-20 Maintenance and repair costs.

(a) Costs necessary for the upkeep of property (including Government property unless otherwise provided for), which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are to be treated as follows (but see § 15.205-9):

(1) Normal maintenance and repair costs are allowable;

(2) Extraordinary maintenance and repair costs are allowable, provided such are allocated to the periods to which applicable for purposes of determining contract costs. (But see § 15.107.)

(b) Expenditures for plant and equipment, including rehabilitation thereof, which, according to generally accepted accounting principles as applied under the contractor's established policy, should be capitalized and subjected to depreciation, are allowable only on a depreciation basis.

#### § 15.205-21 Manufacturing and production engineering costs.

Costs of manufacturing and production engineering, including engineering activities in connection with the following, are allowable:

(a) Current manufacturing processes such as motion and time study, methods analysis, job analysis, and tool design and improvement; and

(b) Current production problems, such as materials analysis for production suitability and component design for purposes of simplifying production.

#### § 15.205-22 Material costs.

(a) Material costs include the costs of such items as raw materials, parts, sub-assemblies, components, and manufacturing supplies, whether purchased outside or manufactured by the contractor, and may include such collateral items as inbound transportation and intransit insurance. In computing material costs consideration will be given to reasonable overruns, spoilage, or defective work (concerning correction of defective work, see the provisions of the contract relating to inspection and correction of defective work). These costs are allowable subject, however, to the provisions of paragraphs (b) through (e) of this section.

(b) Costs of material shall be suitably adjusted for applicable portions of income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap and salvage and material returned to vendors. Such income and other credits shall either be credited directly to the cost of the material involved or be allocated (as credits) to indirect costs. However, where the contractor can demonstrate that failure to take cash discounts was due to reasonable circumstances, such lost discounts need not be so credited.

(c) Reasonable adjustments arising from differences between periodic physical inventories and book inventories may be included in arriving at costs, provided such adjustments relate to the period of performance of the contract.

(d) When the materials are purchased specifically for and identifiable solely with performance under a contract, the actual purchase cost thereof should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if that method is consistently applied and the results are equitable. When estimates of material costs to be incurred in the future are required, either current market price or anticipated acquisition cost may be used, but the basis of pricing must be disclosed.

(e) Charges for materials, services, and supplies sold or transferred between plants, divisions or organizations, under a common control, ordinarily shall be allowable to the extent of the lower of cost to the transferor or current market price. However, a departure from this basis is permissible where (1) the item



is regularly manufactured and sold by the contractor through commercial channels, and (2) it is the contractor's long-established practice to price inter-organization transfers at other than cost for commercial work: *Provided*, That the charge to the contract is not in excess of the transferor's sales price to its most favored customer for the same item in like quantity, or the current market price, whichever is lower.

**§ 15.205-23 Organization costs.**

Expenditures, such as incorporation fees, attorneys' fees, accountants' fees, brokers' fees, fees to promoters and organizers, in connection with (a) organization or reorganization of a business, or (b) raising capital, are unallowable.

**§ 15.205-24 Other business expenses.**

Included in this item are such recurring expenses as registry and transfer charges resulting from changes in ownership of securities issued by the contractor, cost of shareholders' meetings, normal proxy solicitations, preparation and publication of reports to shareholders, preparation and submission of required reports and forms to taxing and other regulatory bodies; and incidental costs of directors and committee meetings. The above and similar costs are allowable when allocated on an equitable basis.

**§ 15.205-25 Overtime, extra-pay shift and multi-shift premiums.**

Premiums for overtime, extra-pay shifts, and multi-shift work are allowable to the extent approved pursuant to § 12.102-4 of this chapter, or permitted pursuant to § 12.102-5 of this chapter.

**§ 15.205-26 Patent costs.**

Costs of preparing disclosures, reports, and other documents required by the contract and of searching the art to the extent necessary to make such invention disclosures, are allowable. In accordance with the clauses of the contract relating to patents, costs of preparing documents and any other patent costs, in connection with the filing of a patent application where title is conveyed to the Government, are allowable. (See § 15.205-36.)

**§ 15.205-27 Pension plans.**

See § 15.205-6.

**§ 15.205-28 Plant protection costs.**

Costs of items such as (a) wages, uniforms, and equipment of personnel engaged in plant protection, (b) depreciation on plant protection capital assets, and (c) necessary expenses to comply with military security requirements, are allowable.

**§ 15.205-29 Plant reconversion costs.**

Plant reconversion costs are those incurred in the restoration or rehabilitation of the contractor's facilities to approximately the same condition existing immediately prior to the commencement of the military contract work, fair wear and tear excepted. Reconversion costs are unallowable except for the cost of removing Government property and the restoration or rehabilitation costs caused by such removal. However, in special circumstances where equity so dictates, additional costs may be allowed to the extent agreed upon before the costs are incurred. Whenever such costs are given consideration, care should be exercised to avoid duplication through allowance as contingencies, as additional profit or fee, or in other contracts.

**§ 15.205-30 Precontract costs.**

Precontract costs are those incurred prior to the effective date of the contract directly pursuant to the negotiation and in anticipation of the award of the contract where such incurrence is necessary to comply with the proposed contract delivery schedule. Such costs are allowable to the extent that they would have been allowable if incurred after the date of the contract (but see § 15.107).

**§ 15.205-31 Professional service costs; legal, accounting, engineering, and other.**

(a) Costs of professional services rendered by the members of a particular profession who are not employees of the contractor are allowable, subject to paragraphs (b) and (c) of this section, when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government (but see § 15.205-23).

(b) Factors to be considered in determining the allowability of costs in a particular case include:

(1) The past pattern of such costs, particularly in the years prior to the award of Government contracts;

(2) The impact of Government contracts on the contractor's business (i.e., what new problems have arisen);

(3) The nature and scope of managerial services expected of the contractor's own organizations; and

(4) Whether the proportion of Government work to the contractor's total business is such as to influence the contractor in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Government contracts.

Retainer fees to be allowable must be reasonably supported by evidence of bona fide services available or rendered.

(c) Costs of legal, accounting, and consulting services, and related costs, incurred in connection with organization and reorganization, defense of antitrust suits, and the prosecution of claims against the Government, are unallowable. Costs of legal, accounting, and consulting services, and related costs, incurred in connection with patent infringement litigation, are unallowable unless otherwise provided for in the contract.

**§ 15.205-32 Profits and losses on disposition of plant, equipment, or other capital assets.**

Profits or losses of any nature arising from the sale or exchange of plant, equipment, or other capital assets, including sale or exchange of either short or long term investments, shall be excluded in computing contract costs (but see § 15.205-9(b) as to basis for depreciation).

**§ 15.205-33 Recruiting costs.**

Costs of "help wanted" advertising, operating costs of an employment office necessary to secure and maintain an adequate labor force, costs of operating an aptitude and educational testing program, travel costs of employees while engaged in recruiting personnel, and travel costs of applicants for interviews for prospective employment are allowable. Where the contractor uses employment agencies, costs not in excess of standard commercial rates for such services are also allowable. Costs of special benefits or emoluments offered to prospective employees beyond the standard practices in the industry are unallowable.

**§ 15.205-34 Rental costs (including sale and leaseback of facilities).**

(a) Rental costs of land, building, and equipment and other personal property are allowable if the rates are reasonable in light of such factors as rental costs of comparable facilities and market conditions in the area, the type, life expectancy, condition, and value of the facilities leased, options available, and other provisions of the rental agreement. Application of these factors, in situations where rentals are extensively used, may involve among other considerations, comparison of rental costs with the amount which the contractor would have received had it owned the facilities.

(b) Charges in the nature of rent between plants, divisions, or organizations under common control are allowable to the extent such charges do not exceed the normal costs of ownership, such as depreciation, taxes, insurance, and maintenance: *Provided*, That no part of such costs shall duplicate any other allowed cost.

(c) Unless otherwise specifically provided in the contract, rental costs specified in sale and leaseback agreements, incurred by contractors through selling plant facilities to investment organizations, such as insurance companies, or to private investors, and concurrently leasing back the same facilities, are allowable only to the extent that such rentals do not exceed the amount which the contractor would have received had it retained legal title to the facilities.

(d) The allowability of rental costs under unexpired leases in connection with terminations is treated in § 15.205-42(e).

**§ 15.205-35 Research and development costs.**

(a) Basic research, for the purpose of this subpart, is that type of research which is directed toward increase of knowledge in science. In such research, the primary aim of the investigator is a fuller knowledge or understanding of the subject under study, rather than any practical application thereof. Applied research, for the purpose of this subpart, consists of that type of effort which (1) normally follows basic research, but may not be severable from the related basic research (2) attempts to determine and expand the potentialities of new scientific discoveries or improvements in technology, materials, processes, methods,

devices, and techniques, and (3) attempts to "advance the state of the art." Applied research does not include any such efforts when their principal aim is the design, development, or test of specific articles or services to be offered for sale, which are within the definition of the term development as hereinafter provided.

(b) Development is the systematic use of scientific knowledge which is directed toward the production of, or improvements in, useful products to meet specific performance requirements, but exclusive of manufacturing and production engineering.

(c) A contractor's independent research and development is that research and development which is not sponsored by a contract, grant, or other arrangement.

(d) A contractor's costs of independent research as defined in paragraphs (a) and (c) of this section shall be allowable as indirect costs (subject to paragraph (h) of this section), provided they are allocated to all work of the contractor.

(e) Costs of contractor's independent development, as defined in paragraphs (b) and (c) of this section (subject to paragraph (h) of this section), are allowable to the extent that such development is related to the product lines for which the Government has contracts, provided the costs are reasonable in amount and are allocated as indirect costs to all work of the contractor on such product lines. In cases where a contractor's normal course of business does not involve production work, the cost of independent development is allowable to the extent that such development is related and allocated as an indirect cost to the field of effort of Government research and development contracts.

(f) Independent research and development costs shall include an amount for the absorption of their appropriate share of indirect and administrative costs, unless the contractor, in accordance with its accounting practices consistently applied, treats such costs otherwise.

(g) Research and development costs (including amounts capitalized), regardless of their nature, which were incurred in accounting periods prior to the award of a particular contract, are unallowable except where allowable as precontract costs (see § 15.205-30).

(h) The reasonableness of expenditures for independent research and development should be determined in light of all pertinent considerations such as previous contractor research and development activity, cost of past programs and changes in science and technology. Such expenditures should be pursuant to a broad planned program, which is reasonable in scope and well managed. Such expenditures (especially for development) should be scrutinized with great care in connection with contractors whose work is predominantly or substantially with the Government. Advance agreements as described in § 15.107 are particularly important in this situation. In recognition that cost sharing of the contractor's independent research and development program may provide motivation for more efficient accomplishment of such program, it is desirable in some cases that the Government bear less than an allocable share of the total cost of the program. Under these circumstances, the following are among the approaches which may be used as the basis for agreement: (1) review of the contractor's proposed independent research and development program and agreement to accept the allocable costs of specific projects; (2) agreement on a maximum dollar limitation of costs, an allocable portion of which will be accepted by the Government; (3) an agreement to accept the allocable share of a percentage of the contractor's planned research and development program.

#### **§ 15.205-36 Royalties and other costs for use of patents.**

(a) Royalties on a patent or amortization of the cost of acquiring by purchase a patent or rights thereto, necessary for the proper performance of the contract and applicable to contract products or processes, are allowable unless:

(1) The Government has a license or the right to free use of the patent;

(2) The patent has been adjudicated to be invalid, or has been administratively determined to be invalid;

(3) The patent is considered to be unenforceable; or

(4) The patent is expired.

(b) Special care should be exercised in determining reasonableness where the royalties may have been arrived at

as a result of less than arm's length bargaining; e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the contractor;

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government contract would be awarded; or

(3) Royalties paid under an agreement entered into after the award of the contract.

(c) In any case involving a patent formerly owned by the contractor, the amount of royalty allowed should not exceed the cost which would have been allowed had the contractor retained title thereto.

(d) See § 15.107, regarding advance understandings.

#### § 15.205-37 Selling costs.

(a) Selling costs arise in the marketing of the contractor's products and include costs of sales promotions, negotiation, liaison between Government representatives and contractor's personnel, and other related activities.

(b) Selling costs are allowable to the extent they are reasonable and are allocable to Government business (but see §§ 15.107 and 15.205-1). Allocability of selling costs will be determined in the light of reasonable benefit to the Government arising from such activities as technical, consulting, demonstration, and other services which are for purposes such as application or adaptation of the contractor's products to Government use.

(c) Notwithstanding paragraph (b) of this section, salesmen's or agents' compensation, fees, commissions, percentages, or brokerage fees, which are contingent upon the award of contracts, are allowable only when paid to bona fide employees or bona fide established commercial or selling agencies maintained by the contractor for the purpose of securing business.

#### § 15.205-38 Service and warranty costs.

Such costs include those arising from fulfillment of any contractual obligation of a contractor to provide services, such as installation, training, correcting defects in the products, replacing defective parts, making refunds in the case of inadequate performance, etc. When not inconsistent with the terms of the contract, such service and warranty costs are

allowable. However, care should be exercised to avoid duplication of the allowance as an element of both estimated product cost and risk.

#### § 15.205-39 Severance pay.

(a) Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages, by contractors to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that, in each case, it is required by (1) law, (2) employer-employee agreement, (3) established policy that constitutes, in effect, an implied agreement on the contractor's part, or (4) circumstance of the particular employment.

(b) Costs of severance payments are divided into two categories as follows:

(1) Actual normal turnover severance payments shall be allocated to all work performed in the contractor's plant; or, where the contractor provides for accrual of pay for normal severances such method will be acceptable if the amount of the accrual is reasonable in light of payments actually made for normal severances over a representative past period, and if amounts accrued are allocated to all work performed in the contractor's plant; and

(2) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis in the event of occurrence.

#### § 15.205-40 Special tooling costs.

The term "special tooling" means all jigs, dies, fixtures, molds, patterns, special taps, special gauges, special test equipment, other special equipment and manufacturing aids, and replacements thereof, acquired or manufactured by the contractor for use in the performance of a contract, which are of such a specialized nature that, without substantial modification or alteration, their use is limited to the production of such supplies or parts thereof, or the performance of such services, as are peculiar to the needs of the Government. The term does not include: (1) Items of tooling or

equipment acquired by the contractor prior to the contract, or replacements thereof, whether or not altered or adapted for use in the performance of the contract, (2) consumable small tools, or (3) general or special machine tools, or similar capital items. The cost of special tooling, when acquired for and its usefulness is limited to one or more Government contracts, is allowable and shall be allocated to the specific Government contract or contracts for which acquired.

#### § 15.205-41 Taxes.

(a) Taxes are charges levied by Federal, State, or local governments. They do not include fines and penalties except as otherwise provided herein. In general, taxes (including State and local income taxes) which the contractor is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, are allowable, except for:

(1) Federal income and excess profits taxes;

(2) Taxes in connection with financing, refinancing or refunding operations (see § 15.205-17);

(3) Taxes from which exemptions are available to the contractor directly or available to the contractor based on an exemption afforded the Government except when the contracting officer determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing to the Government; and

(4) Special assessments on land which represent capital improvements.

(b) Taxes otherwise allowable under paragraph (a) of this section, but upon which a claim of illegality or erroneous assessment exists, are allowable: *Provided*, That the contractor prior to payment of such taxes:

(1) Promptly requests instructions from the contracting officer concerning such taxes; and

(2) Takes all action directed by the contracting officer arising out of subparagraph (1) of this paragraph or an independent decision of the Government as to the existence of a claim of illegality or erroneous assessment, including cooperation with and for the benefit of the Government to (i) determine the legality of such assessment or, (ii) secure a refund of such taxes.

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Reasonable costs of any such action undertaken by the contractor at the direction or with the concurrence of the contracting officer are allowable. Interest and penalties incurred by a contractor by reason of the nonpayment of any tax at the direction of the contracting officer or by reason of the failure of the contracting officer to assure timely direction after prompt request therefor, are also allowable.

(c) Any refund of taxes, interest, or penalties, and any payment to the contractor of interest thereon, attributable to taxes, interest, or penalties which were allowed as contract costs, shall be credited or paid to the Government in the manner directed by the Government, provided any interest actually paid or credited to a contractor incident to a refund of tax, interest or penalty shall be paid or credited to the Government only to the extent that such interest accrued over the period during which the contractor had been reimbursed by the Government for the taxes, interest or penalties.

#### § 15.205-42 Termination costs.

Contract terminations generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the contract not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the remainder of this subpart in termination situations.

(a) Common items: The cost of items reasonably usable on the contractor's other work shall not be allowable unless the contractor submits evidence that it could not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the contractor, the contracting officer should consider the contractor's plans and orders for current and scheduled production. Contemporaneous purchases of common items by the contractor shall be regarded as evidence that such items are reasonably usable on the contractor's other work. Any acceptance of common items as allocable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

(b) Costs continuing after termination: If, in a particular case, despite all

reasonable efforts by the contractor, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this subpart, except that any such costs continuing after termination due to the negligent or willful failure of the contractor to discontinue such costs shall be considered unallowable.

(c) Initial costs, including starting load and preparatory costs, are allowable, subject to the following:

(1) Starting load costs are costs of a non-recurring nature arising in the early stages of production and not fully absorbed because of the termination. Such costs may include the cost of labor and material, and related overhead attributable to such factors as—

(i) Excessive spoilage resulting from inexperienced labor,

(ii) Idle time and subnormal production occasioned by testing and changing methods of processing,

(iii) Employee training, and

(iv) Unfamiliarity or lack of experience with the product, materials, manufacturing processes and techniques.

(2) Preparatory costs are costs incurred in preparing to perform the terminated contract, including costs of initial plant rearrangement and alterations, management and personnel organization, production planning and similar activities, but excluding special machinery and equipment and starting load costs.

(3) If initial costs are claimed and have not been segregated on the contractor's books, segregation for settlement purposes shall be made from costs reports and schedules which reflect the high unit cost incurred during the early stages of the contract.

(4) When the settlement proposal is on the inventory basis, initial costs should normally be allocated on the basis of total end items called for by the contract immediately prior to termination; however, if the contract includes end items of a diverse nature, some other equitable basis may be used, such as machine or labor hours.

(5) When initial costs are included in the settlement proposal as a direct charge, such costs shall not also be included in overhead.

(6) Initial costs attributable to only one contract shall not be allocated to other contracts.

(d) Loss of useful value of special tooling, special machinery and equipment is generally allowable, provided—

(1) Such special tooling, machinery or equipment is not reasonably capable of use in the other work of the contractor;

(2) The interest of the Government is protected by transfer of title or by other means deemed appropriate by the contracting officer; and

(3) The loss of useful value as to any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire terminated contract and other Government contracts for which the special tooling, special machinery and equipment was acquired.

(e) Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated contract, less the residual value of such leases, if—

(1) The amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and

(2) The contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.

There also may be included the cost of alterations of such leased property, provided, such alterations were necessary for the performance of the contract, and of reasonable restoration required by the provisions of the lease.

(f) Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for—

(i) The preparation and presentation to contracting officers of settlement claims and supporting data with respect to the terminated portion of the contract, and

(ii) The termination and settlement of subcontracts; and

(2) Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.

(g) Subcontractor claims, including the allocable portion of claims which are common to the contract and to other work of the contractor are generally allowable.

**§ 15.205-43 Trade, business, technical and professional activity costs.**

(a) *Memberships.* This category includes costs of memberships in trade, business, technical, and professional organizations. Such costs are allowable.

(b) *Subscriptions.* This item includes cost of subscriptions to trade, business, professional, or technical periodicals. Such costs are allowable.

(c) *Meetings and conferences.* This item includes cost of meals, transportation, rental of facilities for meetings, and costs incidental thereto, when the primary purpose of the incurrence of such costs is the dissemination of technical information or stimulation of production. Such costs are allowable.

**§ 15.205-44 Training and educational costs.**

(a) Costs of preparation and maintenance of a program of instruction at non-college level, designed to increase the vocational effectiveness of bona fide employees, including training materials, textbooks, salaries or wages of trainees (excluding overtime compensation which might arise therefrom), and

(1) Salaries of the director of training and staff when the training program is conducted by the contractor; or

(2) Tuition and fees when the training is in an institution not operated by the contractor; are allowable.

(b) Costs of part-time education, at an under-graduate or post-graduate college level, related to the job requirements of bona fide employees, including only:

(1) Training materials;

(2) Textbooks;

(3) Fees charged by the educational institution;

(4) Tuition charged by the educational institution, or in lieu of tuition, instructors' salaries and the related share of indirect cost of the educational institution to the extent that the sum thereof is not in excess of the tuition

which would have been paid to the participating educational institution; and

(5) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year where circumstances do not permit the operation of classes or attendance at classes after regular working hours; are allowable.

(c) Costs of tuition, fees, training materials and textbooks (but not subsistence, salary, or any other emoluments) in connection with fulltime scientific and engineering education at a post-graduate (but not under-graduate) college level related to the job requirements of bona fide employees for a total period not to exceed one school year for each employee so trained, are allowable. In unusual cases where required by military technology, the period may be extended.

(d) Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the contractor for training purposes are allowable to the extent set forth in §§ 15.205-20, 15.205-9, and 15.205-34, respectively.

(e) Grants to educational or training institutions, including the donation of facilities or other properties, scholarships or fellowships, are considered contributions and are unallowable.

**§ 15.205-45 Transportation costs.**

Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly costed as transportation costs or added to the cost of such items (see § 15.205-22). Where identification with the materials received cannot readily be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the contractor follows a consistent, equitable procedure in this respect. Outbound freight, if reimbursable under the terms of the contract, shall be treated as a direct cost.

**§ 15.205-46 Travel costs.**

(a) Travel costs include costs of transportation, lodging, subsistence, and incidental expenses, incurred by contractor personnel in a travel status while on official company business.

(b) Travel costs may be based upon actual costs incurred, or on a per diem

or mileage basis in lieu of actual costs, or on a combination of the two, provided the method used does not result in an unreasonable charge.

(c) Travel costs incurred in the normal course of over-all administration of the business are allowable and shall be treated as indirect costs.

(d) Travel costs directly attributable to specific contract performance are allowable and may be charged to the contract in accordance with the principle of direct costing (see § 15.202).

(e) Necessary, reasonable costs of family movements and personnel movements of a special or mass nature are allowable, subject to allocation on the basis of work or time period benefited when appropriate. (But see § 15.107.)